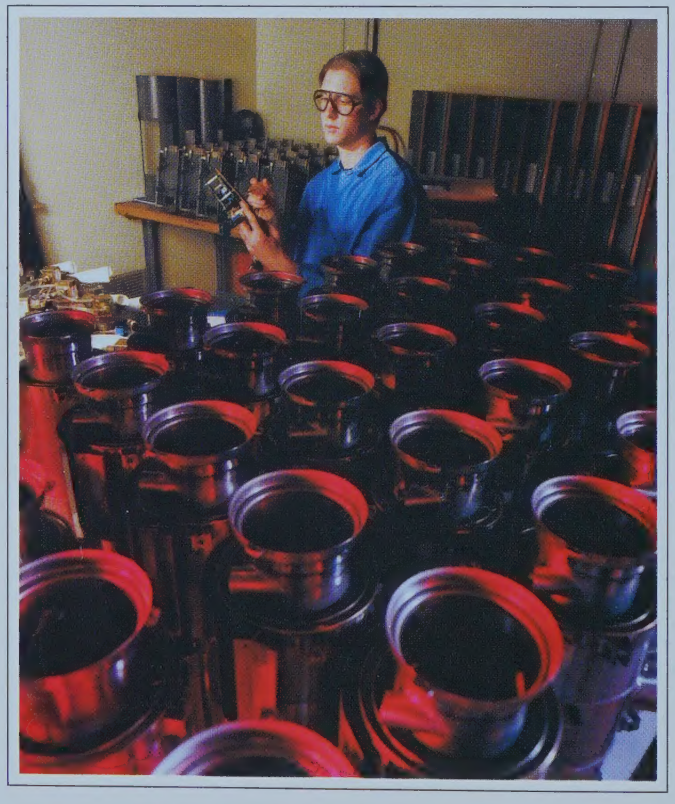
1997 ANNUAL REPORT

GLOBAL THERMOELECTRIC

INDEX

ANNUAL MEETING

The Annual & Special Meeting of the Shareholders of the Corporation will be held at the Calgary Chamber of Commerce, 517 Centre Street South, Calgary, Alberta on Thursday, August 14, 1997 at 3:00 pm.



Heat exchangers for the new Global Heater, manufactured for the U.S. Army.

Our Business

Global Thermoelectric Inc. is an Alberta based industrial company engaged in the development, manufacture and sale of thermoelectric products, special purpose heater products and in the research and development of technologies for the conversion of fuel energy into power.

Global is the world's largest supplier of thermoelectric products.

The Company's shares trade on The Alberta Stock Exchange.

Mission Statement

To be the world's leading supplier of devices for reliably converting fuel energy directly into electric power or heat. To provide our Customers with innovative and exceptional quality solutions, so that our Company, Shareholders and Employees will prosper.

Executive Team

FINANCIAL HIGHLIGHTS ($ THOUSANDS EXCEPT PER SHARE AMOUNTS)

Years ending March 31	**1997**	1996	1995
Revenue	**$9,649**	$5,854	$11,266
Net Earnings (Loss)	**649**	(815)	1,116
Earnings per Share - Basic	**0.04**	(0.11)	0.12
Cash Flow from Operations	**1,157**	(396)	1,591
Capital Expenditures	**277**	484	612
R&D Expenditures	**424**	528	179

HIGHLIGHTS OF THE YEAR

Revenues increased by 65% to $9.6 million.

Net income improved to $649 thousand (4 cents a share) from a loss of $815 thousand (11 cents a share) in the previous year.

Awarded an $18 million, three-year contract by the US Army for the supply of personnel heaters in armoured vehicles.

Awarded $3.2 million contract by the Gas Authority of India for thermoelectric generators, the largest individual generators contract in the Company's history.

Raised $548 thousand of equity through a rights offering.

Common shares commenced trading on the Alberta Stock Exchange.

Message to Shareholders

In the last year your company has successfully executed its business goals which, coupled with new initiatives, have positioned Global Thermoelectric on a clear path for future growth.

Financial results improved substantially over the prior year, and this occurred primarily in the last half of the year. Revenues grew from $5.8 million in fiscal 1996 to $9.6 million in fiscal 1997, an improvement of 65 per cent. Net earnings rose to $649 thousand or 4 cents a share as compared to a loss of $815 thousand or 11 cents a share a year earlier. Operating cash flow, before working capital changes, rose to $1.2 million from a cash flow deficiency of $396 thousand in fiscal 1996. The last two quarters of the year produced aggregate revenues of $7.3 million and net earnings of $941 thousand.

A $5.8 million backlog of orders for Thermoelectric Generators (TEG's) was on hand at March 31, 1997, and this will result in a solid first quarter performance. A renewed emphasis on international marketing of TEG products was particularly rewarding with major orders being received from India, China and Latin America. The $3.2 million order from the Gas Authority of India was the largest single TEG order ever won by the Company. This order presented many technical challenges that were successfully met by our engineering and manufacturing groups.

In addition to major overseas orders for TEG products, we have experienced an increase in domestic demand as a result of record levels of oil and gas drilling and pipeline construction activity. We believe that this trend will continue.

Personnel Heaters, a new business activity, commenced operations during the year following the award of a US military production contract worth a total value of $18 million. The contract includes an initial phase worth $4 million to manufacture 300 heaters and perform initial production testing. Upon test acceptance, the Company will receive a $6.3 million order for delivery of 1700 heaters. The contract also has options worth $7.7 million for another 2000 heaters and spare parts. Global Thermoelectric was selected by the US Army Tank Command to be the sole supplier of replacement personnel heaters for all its armored vehicles. Global won this contract after outperforming established US suppliers in all categories during a head to head competition.

This diesel fired heater represents a new product line for Global, and in addition to the three-year exclusive contract with Tank Command, we foresee numerous other possibilities. Military market opportunities exist within other branches of the US forces as well as Canadian and NATO commands. Since this product is a replacement for existing heaters, the market comprises the full population of armored vehicles, not only additions to the fleet.

Commercial heater applications are also under active market investigation. Market opportunities exist in the transportation industry for cargo heating and coolant heating in extreme climates, and for industrial space heating.

Research and Development activities were focused on technologies that will complement our thermoelectric generator business by broadening the range of power requirements that can be satisfied by the Company's products. This will position the Company for expansion into industry markets not currently served that will be counter-cyclical to energy industry activity levels.

R&D spending of $424 thousand represents a reinvestment of 36% of operating cash flow.

Principal activities have included the investigation of Fuel Cell technologies and the pursuit of strategic alliances and arrangements that will provide Global Thermoelectric with access to technology for exploitation of niche markets.

Trading of the Common Shares commenced in September 1996 following a successful rights offering which generated net proceeds of $548 thousand. The share price has doubled since trading began, reflecting the improved financial performance and outlook for the Company.

Jim F. Perry
President

A new President was appointed effective June 2, 1997. We are extremely pleased to welcome Jim F. Perry to the Global team. Jim was most recently Executive Director of Petro-Trade, the oil and gas service industry international marketing organization. He has been involved with the high technology segment of the energy services industry throughout his career, which has included assignments in the USA in addition to Canada.

Changes also occurred at the Board level. Jim McBride, who has served as Chairman since 1993 is stepping down from that position, but will remain a director of the Company. Bob Snyder, former Senior Vice-President, Nova Gas Transmission, who has served as Managing Director since November, 1995 and Interim President since August, 1996 has been elected as Chairman of the Board. John Howard joined the Board in August of 1996. Bernie LeSage, formerly General Manager, Generator Division was appointed Vice-President, Generator Division in February 1997.

Once again we thank our employees for their enthusiasm and dedication in responding to the many challenges that have come before them.

The future of your company is extremely positive. The natural gas production and pipeline transmission industry represents the principal customer base for TEG products. We anticipate a continuation of robust activity levels and demand in both North American and overseas markets.

The Heater Division, with a major contract in place, has a sound base from which to develop additional markets, both military and commercial. An aggressive effort is underway to identify and capture these opportunities.

A focused Research and Development program is designed to seek out and commercialize business initiatives that are complementary to the generator and heater product lines. This effort has identified a number of prospects where Global's engineering, manufacturing and marketing skills can be used to develop quality products for niche markets.

These interrelated but balanced corporate development initiatives are aimed at increasing shareholder values by building on your company's strengths and continually searching for new opportunities for further growth.

Jim McBride

Robert Snyder

Operating Reviews

Generator Division

The Thermoelectric technology used in Global's generators was originally developed by 3M Company for use in the Apollo Space Program to power instruments on the Moon. Today Global's generators are providing a clean, reliable and low maintenance source of power in a wide variety of applications in all corners of the world.

A Thermoelectric Generator (TEG) produces power through the direct conversion of heat into energy. By maintaining a temperature difference across a thermopile, which is an assembly of semi-conductor thermoelectric elements, a steady power level is produced. Combustion of fuel provides the source of heat while natural convection provides the cooling required to create the temperature differential. A TEG has no moving parts and thus requires minimal maintenance making it an ideal power source in remote locations.

Depending on the size of the thermopile, the power output of one TEG can be from 15 to 550 watts, and TEG's can be combined to increase power output up to 5,000 watts at one location.

As befitting its name, Global is the largest supplier of TEG's in the world and, through its sales offices in Calgary, Alberta; Houston, Texas; Harbin, China and a network of distributors and agents, the Company pursues marketing and business development opportunities worldwide.

The energy industry has been a major customer base for Global's remote power products, chiefly for cathodic protection systems and SCADA (Supervisory Control & Data Acquisition) applications. Providing a power source at remote telecommunication facilities is another market serviced by Global.

A highlight of the year was the award of a contract, valued at over $3 million, by the Gas Authority of India for the supply of 110 of Global's 8550 generators. The generators are configured in 11 systems of 5,000 watts each and are used to power automation, communications, cathodic protection and support systems along a 500-kilometre pipeline. This contract presented some interesting technical challenges to the Global engineering team in the development of the specialized electronics to allow for the remote control of the power generation systems. Approximately one third of this order was shipped in fiscal 1997 with the balance delivered in the first quarter of fiscal 1998.

Another major international order was from the Beijing Natural Gas Transportation Company for the provision of power at 16 sites along the 900-kilometre Shaanjing pipeline. This will be the largest pipeline in China, and Global's 1500 watt systems will provide power for cathodic protection, SCADA (Supervisory Control and Data Acquisition) and telecommunications systems.

Latin America is seeing an increasing level of energy transportation development, and Global is participating as the chosen source of remote power needs. Gasoducto Gas Andes contracted with Global to provide power for 11 sites along the 465-kilometre pipeline from Argentina to Chile. Global's generators will meet cathodic protection and SCADA power requirements.

Assembly of Model 8550's at Bassano Manufacturing Plant

Strong Canadian demand for Global's thermoelectric generators is a result of record levels of oil and gas drilling and pipeline construction. Stable energy prices, availability of financing and an increasing access to US markets drive these activity levels. In the United States, where competition from solar power is more intense, Global has seen some strengthening of demand and anticipates a continuation of that trend.

Through product innovations and aggressive marketing, Global will continue to be the largest supplier of Thermoelectric generators in the world.

Bassano Manufacturing Facility

Continuous improvement at the plant has resulted in maintaining a safe, quality oriented environment while meeting the demands of our generator business, including the successful completion of the India project while preparing for the production of the new heater line.

The Safety Committee continued to promote a safe working environment and work habits that resulted in only one lost time accident in the year, ending a record of 296 days without a lost time accident.

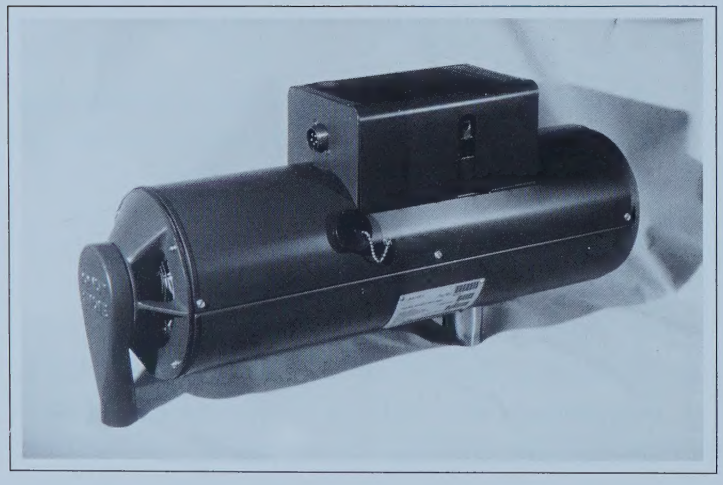
Global continues to hold the ISO 9002 quality registration, passing a full audit of its quality procedures by the new registrar, Warnock Hersey.

Through productivity improvements the Plant Team shortened the delivery time for standard product. Over the year the average delivery time was reduced dramatically. This was achieved while meeting the demands of the India project, setting up for Heater production and responding to an aggressive Canadian market that outstripped forecast by 50% in the fourth quarter.

Floor space utilization and materials management was improved allowing for the assembly and test of the India project and preparation of the Heater assembly area without major additions to the facility. To accomplish this, 3,055 square feet of storage area was refurbished into useable assembly space, and an unused test area of 1,065 square feet was utilized for materials storage.

In Fiscal 1998 the Bassano team looks forward to producing the heater product line, commissioning the new process stand, making available another 650 square feet, and implementing a capital program to upgrade our manufacturing capabilities.

Heater Division



A-20 Global Heater

As a result of three years of concentrated effort, Global has been successful in creating a new business line that is independent of the energy industry activity cycle.

In 1993 Global Thermoelectric, along with US based suppliers, was contracted by the United States Army Tank Automotive Command (TACOM) to undertake research for a pre-production personnel heater prototype.

TACOM's requirements were for a heater that would replace existing outmoded heaters but with no modifications to the vehicle or fuel supply system. The prototypes were subject to extensive testing over a three year period to ensure that the customer's exacting specifications for heat output, reliability, low noise level, size and low full cycle acquisition and operating cost were met.

In June 1996 Global was selected as the preferred supplier and awarded a contract valued at $18 million for an initial supply of up to 4,000 heaters over a three-year period. The US Army has a total of over 30,000 vehicles, such as the Abrams Main Battle Tank, the Bradley Fighting Vehicle and the Paladin Self Propelled Howitzer Vehicle that use this type of heater to provide personnel heating. Plans to upgrade and modernize the vehicle fleet will require additional procurement of new heaters.

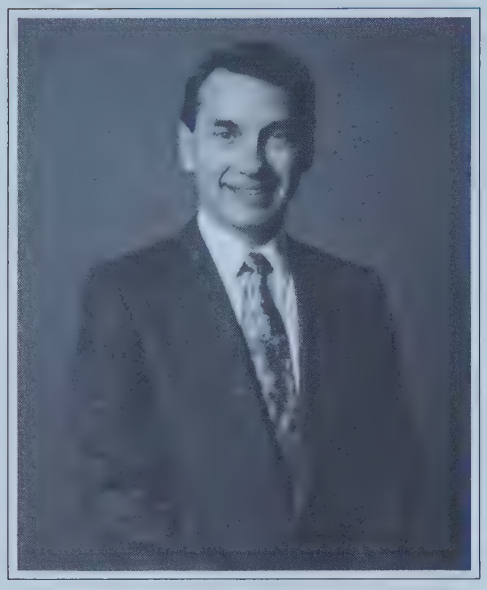
The A-20 Global Heater is designed and tested to a heat output of 60,000 Btu/hr, equivalent to a domestic heating furnace, from a main body package that measures 8 inches in diameter and 27 inches long. The A-20 Global Heater is microprocessor controlled, operates effectively in extremely rugged conditions, and has a long service life.

During the initial contract period Global is the exclusive supplier to TACOM. Following this period, the supply of heaters that match Global's specifications will be open to competitive bidding.

Significant additional military markets exist for this product, and Global is moving aggressively to develop them. The rigorous testing procedures utilized by TACOM have served to effectively pre-qualify Global's product with other branches of the US military, such as the Marine Corps, and with other NATO defense forces.

Commercial market potential for this product line is also under investigation. Commercialization may require a lower output, less rugged version of the heater, and these modifications will change the cost structure of the product. Cargo heaters for the transportation industry, coolant heaters for extreme weather use by the trucking industry and industrial space heating applications are all potential market opportunities.

Global is committed to the development of the Heater business as an avenue for corporate growth, and the award of the large TACOM contract is evidence of the success of this strategy.



Jim Lumsden
Vice President,
Research & Development

Research and Development

The commitment to Research and Development is crucial for Global's future growth and prosperity. The Company has invested aggressively in R&D activities and intends to continue on this course.

Global's strategy is not to undertake pure research, but rather to actively monitor research developments in appropriate fields, and establish technology alliances enabling Global to independently pursue niche market opportunities.

A primary focus of attention has been Fuel Cell development. Fuel Cells, both solid oxide (SOFC) and polymer exchange membrane (PEM), will efficiently provide power at remote locations and thus fit with Global's business strategy.

Access to Fuel Cell technology will enable Global to offer higher wattage products to its current customers and also to expand target markets. In addition to oil and gas industry projects, Global believes that the telecommunications industry and the home co-generation market offer specific opportunities.

In the past year Global's team has investigated a number of potential technology partners. Negotiations are currently underway with two US based entities that, if successfully concluded, will provide the Company with access to both SOFC and PEM fuel cell technology. The Company hopes to conclude these arrangements within the next six months.

Development of commercial Heater products is another focus of our R&D program. In conjunction with the ongoing evaluation of commercial market opportunities for the military heater, our R&D team will be developing the product to meet identified commercial applications.

Continuous improvement to Generator products occupies a place in our R&D efforts. The aim of this element of our program is to achieve manufacturing cost reductions in our TEG product line. This will be accomplished by perfecting new thermopile assembly techniques and other component redesigns.

Global's R&D activities are a key element of the Company's strategy. The focus is on existing product improvement and accessing and developing new technologies for business development.

Management's Discussion & Analysis

The following discussion and analysis of financial condition and the results of operations for the years ended March 31, 1997 and 1996 should be read in conjunction with the financial statements and related notes commencing on page 15 of this Annual Report.

Results from Operations

Revenues increased by 65% to $9,648,749 from $5,853,843 in the prior year and resulted in net earnings of $649,311 (4 cents a share) versus a loss of $814,933 (11 cents a share) a year earlier.

The increase in revenues is attributable to higher thermoelectric generator sales, which rose to $7,636,974 versus $5,824,950 in the previous year and to the commencement of heater sales, which totaled $2,011,775 versus $28,893 in fiscal 1996. The increase in generator sales is due to a number of large overseas orders, particularly from the Gas Authority of India, coupled with a rise in domestic sales as a result of robust oil and gas industry activity. The increase in heater sales is a result of the award of a three year contract by the United States Army Tank Automotive Command.

Cost of Sales rose from $4,345,344 to $6,424,021 reflecting the higher sales volumes as described above. Gross Profit as a percentage of revenues increased from 26% to 33% due to fixed manufacturing costs being absorbed by a higher sales volume, production efficiencies, and as a result of the commencement of the heater contract.

Higher marketing expenses reflect the increased emphasis on international sales activity that has produced a number of significant orders. Administration expenses were higher due to an overall increase in the level of business activity coupled with costs associated with the change in the Office of the President. Research expenses were significantly lower in fiscal 1997 than in fiscal 1996 because costs associated with the heater contract were classified as cost of sales following contract award in fiscal 1997.

Income tax expense of nil is principally the result of non-capital losses incurred in prior years being carried forward to shelter current years taxable income. The Company has non-capital losses of $51,917 and research and development expenditures of $2,170,507 available to offset future years' taxable income.

Liquidity and Capital Resources

Cash flow from operating activities, before working capital changes, increased to $1,157,183 from a deficit of $396,256 in the prior year as a result of improved profitability, as described in Results from Operations above. Working capital requirements were $3,443,470 as a result of higher levels of receivables and inventory associated with increased revenues, versus a decrease in working capital requirements of $800,983 in fiscal 1996 due to declining year on year revenues.

The increasing proportion of revenues represented by large international orders requires higher working capital requirements due both to the contract size and the extended manufacturing and delivery period. At March 31, 1997 receivables and work in progress inventory related to the Gas Authority of India contract amounted to $1.2 million and $850 thousand respectively. In response to the working capital requirements of this contract, the Company established an additional operating line of credit of $1.7 million to provide the necessary funds.

Financing activities resulted in a cash increase of $209,662 as compared to a cash utilization of $78,703 in the previous year. In fiscal 1997 preferred share dividend payments of $195,808 and net long-term debt repayments of $142,688 offset the net proceeds of the rights offering of $548,158.

Investing activities required cash of $686,102, a decrease from the level of $1,010,936 in fiscal 1996. Capital expenditures, which are in respect of process and plant improvements, declined to $276,754 from $484,308 while product development costs fell to $423,657 from $527,928. The decrease in capital expenditures is a result of a reduced requirement for plant improvements due to prior period expenditures. The decline in product development expenditures is due to a reassignment of engineering personnel from development projects to production engineering work to respond to the increase in the volume of orders requiring a high level of engineering input.

At March 31, 1997 working capital was $2,351,721 and the current ratio was 1.43:1 as compared to working capital of $1,707,625 and a current ratio of 2.08:1 a year earlier. The Company has an operating line of credit, including that in respect of the India contract, totalling $2,900,000, secured by accounts receivable, inventory and a general security agreement over all assets. At March 31, 1997, borrowings under the line of credit totalled $2.4 million. This amount was reduced to $1.8 million by May 31, 1997 as a result of collections of revenues from the Gas Authority of India contract.

Business Risks and Outlook

The Company's sales of Thermoelectric Generator products are significantly influenced by the level of gas drilling activity and gas pipeline construction and maintenance. In addition, the timing of major contract awards and resultant product deliveries will affect the level of sales in any one period. Major international contracts are subject to competitive bidding and a significant time period can elapse between the commencement of the tender process and delivery of products. In certain geographic markets the Company's thermoelectric generator products compete with solar power devices.

The level of gas drilling in North America is forecast to remain at a high level and possibly increase. A number of new pipeline projects are planned to improve access to the USA market by Canadian gas producers. Large gas delivery infrastructure projects are ongoing and planned in Latin America and Asia. The combined effect of these developments is to create a robust demand level in the Company's primary market for its thermoelectric generators.

In the short term, the demand for the Company's A-20 Global Heater is governed by the current contract with TACOM, and timing of deliveries is dependent upon the testing cycle currently underway. Additional military and commercial markets for heater products are currently under active investigation, although it is not considered likely that sales to new customers will occur in fiscal 1998.

Research and development activities into fuel cell applications will continue throughout fiscal 1998 with the objective of concluding alliances and arrangements that will give the Company access to proprietary technology. Commercialization of these initiatives will occur in 1999 or later.

To the Shareholders of

Global Thermoelectric Inc.

We have audited the balance sheet of Global Thermoelectric Inc. as at March 31, 1997 and 1996 and the statements of earnings and deficit and changes in financial position for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 1997 and 1996 and the results of its operations and changes in its financial position for the year then ended in accordance with generally accepted accounting principles.

Deane Raymond

Calgary, Alberta
May 16, 1997

Chartered Accountants

Statements of Earnings and Deficit

Year Ended March 31	1997	1996
Sales	$ 9,648,749	$ 5,853,843
Cost of sales	6,424,021	4,345,344
Gross profit	3,224,728	1,508,499
Expenses		
Marketing	812,658	639,082
Administration	1,093,932	976,429
Research	104,101	228,068
Interest on long-term debt	56,854	61,176
	2,067,545	1,904,755
Earnings (loss) before undernoted	1,157,183	(396,256)
Depreciation	241,596	212,984
Amortization of deferred development costs	259,423	205,809
Loss (gain) on sale of fixed assets	6,853	(116)
	507,872	418,677
Earnings (loss) before income taxes	649,311	(814,933)
Income taxes (Note 10)	—	—
Net earnings (loss)	$ 649,311	$ (814,933)
Basic earnings (loss) per common share	$ 0.04	$ (0.11)
Deficit, beginning of year	$(2,497,353)	$ (1,488,952)
Net earnings (loss)	649,311	(814,933)
Dividends - preferred shares	(195,808)	(193,468)
Deficit, end of year	$(2,043,850)	$ (2,497,353)

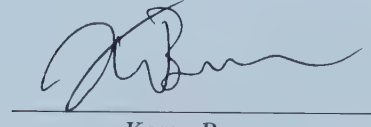
See accompanying notes to the financial statements.

Balance Sheet

March 31	1997	1996
Assets		
Current		
Receivables	$ 4,194,745	$ 1,324,848
Investment tax credits recoverable	439,466	233,262
Inventories	2,995,659	1,678,667
Prepaids	176,815	53,000
	7,806,685	3,289,777
Property and equipment (Note 4)	1,573,244	1,559,248
Deferred product development costs (Note 5)	1,001,042	836,808
	$10,380,971	$ 5,685,833
Liabilities		
Current		
Bank indebtedness (Note 3)	$ 3,059,471	$ 296,744
Payables and accruals	1,680,895	959,025
Warranty accrual	197,400	172,000
Deferred revenue	326,168	—
Current portion of long-term debt, debenture and obligations under capital lease	191,030	154,383
	5,454,964	1,582,152
Long-term debt (Note 6)	—	22,208
Debenture (Note 7)	—	146,178
Obligations under capital lease (Note 8)	132,922	213,871
	5,587,886	1,964,409
Shareholders' Equity		
Capital stock (Note 9)	6,111,936	5,493,778
Contributed surplus (Note 9)	724,999	724,999
Deficit	(2,043,850)	(2,497,353)
	4,793,085	3,721,424
	$10,380,971	$ 5,685,833

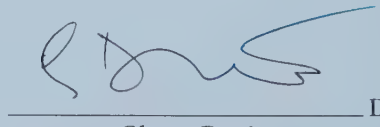
Contingencies and commitments (Notes 11 and 12)

On behalf of the Board



Director

Kerry Brown



Director

Glynn Davies

See accompanying notes to the financial statements.

Statement of Changes in Financial Position

Year Ended March 31	1997	1996
Cash derived from (applied to)		
Operating		
Net earnings (loss)	$ 649,311	$ (814,933)
Depreciation and amortization	501,019	418,793
Loss (gain) on disposal of property and equipment	6,853	(116)
	1,157,183	(396,256)
Change in non-cash operating working capital	(3,443,470)	800,983
	(2,286,287)	404,727
Financing		
Proceeds from long-term debt	14,343	305,594
Repayment of long-term debt	(157,031)	(190,829)
Conversion of debentures	(70,000)	—
Issue of shares on conversion	70,000	—
Issue of shares for cash	613,880	—
Share issue costs	(65,722)	—
Dividends paid	(195,808)	(193,468)
	209,662	(78,703)
Investing		
Purchase of equipment	(276,754)	(484,308)
Proceeds on sale of property and equipment	14,309	1,300
Deferred product development costs net of investment tax credits and write-offs	(423,657)	(527,928)
	(686,102)	(1,010,936)
Decrease in cash	(2,762,727)	(684,912)
(Bank indebtedness) cash, Beginning of year	(296,744)	388,168
End of year (Note 3)	$(3,059,471)	$ (296,744)

See accompanying notes to the financial statements.

Notes to the Financial Statements

March 31, 1997

1. Nature of operations

The Company manufactures and distributes thermoelectric power generators and heaters to customers both in Canada and internationally. It also conducts research and development on heaters and remote power devices.

2. Summary of significant accounting policies

Inventories

Inventories of finished goods and work in process are valued at the lower of cost and net realizable value. Raw materials and supplies are valued at the lower of cost and replacement cost. Cost includes material, labour and manufacturing overhead. Cost is determined on a first-in, first-out basis.

Property and equipment

Property and equipment are recorded at cost. Depreciation is applied to write-off the cost less estimated salvage value of property and equipment over their estimated lives on a straight-line basis as follows:

Buildings	5%
Furniture and fixtures	20%
Machinery and equipment	10%
Computer equipment	20%
Leasehold improvements	16 2/3%

Research and development

Research costs are expensed as incurred. Development costs are expensed unless they meet specific criteria related to technical, market and financial feasibility, in which case they are deferred and amortized on a straight-line basis over four years commencing with the first year of production of the related products.

Foreign currency

The Company uses the current rate method for the translation of foreign currency. Under this method, assets and liabilities are translated at the exchange rate prevailing at the balance sheet date. Revenues and expenses are translated at the rate of exchange prevailing at the transaction date. Translation gains or losses are included in earnings.

Investment tax credits

Investment tax credits are accounted for using the cost reduction method, under which investment tax credits are deducted from the cost of the related property and equipment or expenses. Depreciation and amortization are calculated on the net amount of the related property and equipment.

2. Summary of significant accounting policies (Continued)

Earnings per share

The calculation of basic earnings per share is based on the weighted average number of shares outstanding during the period. The fully diluted earnings per share calculation is anti-dilutive.

3. Bank indebtedness

	1997	1996
Cash	$ (675,091)	$ (27,232)
Operating line of credit	(2,384,380)	(269,512)
	$(3,059,471)	$ (296,744)

The Company has secured an operating line of credit of $2,900,000. As security, the Company has pledged accounts receivable, inventory and a general security agreement over all assets.

4. Property and equipment

	Cost	Accumulated Depreciation	1997 Net Book Value	1996 Net Book Value
Land	$ 16,694	$ —	$ 16,694	$ 16,694
Building and leasehold improvements	1,330,445	956,673	373,772	359,256
Machinery and equipment	2,927,493	2,092,719	834,774	784,035
Equipment under capital lease	513,161	165,157	348,004	399,263
	$ 4,787,793	$ 3,214,549	$ 1,573,244	$ 1,559,248

5. Deferred product development costs

	1997	1996
Deferred product development costs, beginning of year	$ 836,808	$ 514,689
Costs incurred during the year	523,141	607,248
Investment tax credits earned	(99,484)	(79,320)
Amortization	(259,423)	(205,809)
	164,234	322,119
Deferred product development costs, end of year	$ 1,001,042	$ 836,808

Deferred product development costs represent costs incurred to date and do not necessarily reflect present or future value.

6. Long-term debt

	1997	1996
Mortgage payable, secured by land and buildings, payable in monthly principal payments of $5,556 and interest at bank prime rate plus 2%, maturing in July, 1997	$ 22,208	$ 88,880
Less current portion included in current liabilities	(22,208)	(66,672)
	$ —	$ 22,208

7. Debenture

	1997	1996
Debenture payable	$ 76,178	$ 146,178
Less current portion included in current liabilities	76,178	—
	$ —	$ —

The amount due to Foundation Equity Corporation is comprised of a debenture in the amount of $76,178 which bears interest at a rate of 10% per annum. The debenture is repayable by August, 1997 or convertible at the option of the holder into common shares at a rate of one share per $0.40 if exercised prior to August, 1997.

The debenture is secured by a charge against the building, machinery and equipment, subordinate to the long-term debt per Note 6.

8. Obligations under capital lease

	1997	1996
Capital leases, varying effective interest rates from 10.6% to 17.29%, each secured by specific equipment, repayable in aggregate monthly instalments of $9,501, including interest, due at varying dates to February, 2001.	$ 225,566	$ 301,582
Less current portion included in current liabilities	92,644	87,711
	$ 132,922	$ 213,871

Future minimum lease payments under long-term capital leases are as follows:

1998	$ 114,010
1999	104,921
2000	33,692
2001	7,451
	260,074
Amount representing interest	34,508
	$ 225,566

9. Capital stock

Authorized:	Number of Shares	Amount
Unlimited number of common shares, without nominal or par value		
Unlimited number of preferred shares, issuable in series		
Issued:		
Common shares:		
Balance, March 31, 1995 and 1996	9,452,192	$ 3,917,224
Issued for cash - rights offering	2,019,698	565,515
Issued on conversion of debenture	233,333	70,000
Issued on exercise of warrants	141,941	48,365
Share issue costs	—	(65,722)
Balance, March 31, 1997	11,847,164	4,535,382
Series 1 preferred shares:		
Balance, March 31, 1995, 1996 and 1997	666,500	1,576,554
		$ 6,111,936

The Series 1 preferred shares are redeemable by the Company, bear a 10% cumulative dividend, and are convertible at a rate of 4 common shares for 1 preferred share outstanding using a conversion price of $0.75 per common share. The shares are non-voting except when dividends are in arrears in which case each preferred share is entitled to 4 votes.

During the year, the Company issued 233,333 common shares on the conversion of one outstanding debenture at a rate of $0.30 per common share.

Warrants:

Pursuant to the common share rights issue, 200,000 share purchase warrants were issued. Each warrant entitles the holder to acquire 1 common share at $0.28 per share, expiring October 13, 1997. At March 31, 1997, 85,000 share purchase warrants remained outstanding.

Options:

The Company has reserved for issuance to directors and officers of the Company, stock options outstanding:

Issue Date	Number of Shares	Issue Price	Expiry Date
August 14, 1996	50,000	$ 0.28	August 14, 1999
December 12, 1996	400,000	$ 0.40	December 12, 2001
February 10, 1997	50,000	$ 0.55	February 10, 2002

10. Income taxes

Income tax expense differs from the amount which would be obtained by applying the basic combined Federal and Provincial tax rate to the respective years' earnings before income taxes. These differences result from the following items:

	1997	1996
Expected income tax expense at 36.62% (1996 - 36.62%)	$ 237,768	$ (298,428)
Increase (decrease) resulting from:		
Excess of depreciation over capital cost allowance	(22,776)	(22,011)
Amortization of deferred development costs	95,001	75,367
Other	11,803	15,027
Scientific research expenditures claimed	(36,998)	—
Investment tax credits applied against expenses for accounting purposes	(39,081)	(10,132)
Unrecorded loss carry-forward	—	240,177
Reduction of income taxes by utilization of losses carried forward	(245,717)	—
	$ —	$ —

The Company has non-capital losses to carry-forward to reduce future taxable income of $51,917 expiring in 2003. The benefits to be derived from these losses are not reflected in these financial statements.

In addition, the Company has research and development expenditures of $2,170,507 which are deductible from future years' taxable income.

11. Contingencies

The Company has arranged for an operating line of credit at the bank to support Letters of Credit and Guarantees to a maximum of $1,112,539 U.S. At March 31, 1997, the Company had utilized Letters of Credit and Guarantees in the amount of $690,451 of that facility (1996 - $115,784). Security for the letters is covered under the Operating Line of Credit per Note 3.

An action was commenced against the Company in May, 1992 based on wrongful termination of employment, in which damages of $90,000 are claimed. The Company has filed a Statement of Defence and a counterclaim against this individual.

The Company is not yet able to predict the potential outcome, but it believes that its potential exposure is substantially less than the amount claimed.

Any costs arising from the settlement of the claim will be recorded as an expense in the year the amount is determinable.

12. Commitments

The Company has entered into a lease for office premises expiring in December, 2001. The annual rent of premises consists of minimum rent plus taxes, maintenance, heat and certain other expenses. Future minimum lease payments for the fiscal years ending March 31, are as follows:

1998	$ 77,140
1999	$ 82,220
2000	$ 83,490
2001	$ 54,293

13. Segmented information

The Company operates in one business segment as described in Note 1. Export sales for the year ended March 31, 1997 were $4,611,031 (1996 - $3,447,809).

14. Subsequent event

Subsequent to year end, the Company approved further stock options for 200,000 common shares, to be granted on June 2, 1997 at $0.55 per share, expiring on June 1, 2002.

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Director and Secretary
President, Foundation Equity Corporation

John W. Chomiak
Director
President, Hemisphere Engineering Inc.

Glynn G. Davies (1)
Director
Independent Businessman

John Howard (1)
Director
Partner, Howard Kirkpatrick Amerongen
Chartered Accountants

Jim McBride
Director
President, Prairie Metal Industries Ltd.

Robert Snyder
Director and Chairman
Former Senior Vice President
Nova Gas Transmission Ltd.

Keith Wiggins
Director
Former Senior Financial Officer
Government of Alberta

Officers and Management

Robert Snyder
Chairman & CEO

James F. Perry
President

Jim R. Lumsden
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Research & Development

Bernie LeSage
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Gordon McBride
Manager, Engineering

Eric Potter
International Business Development
Manager

Dan Thornton
U.S. & Int'l Sales Manager

Daryl K. Marling
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George Longmuir
Plant Manager

Larry I. Kyle
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Montreal Trust Company of Canada
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